For leased access programming on the BST or on a CPST, the Commission does not include in the opportunity cost formula any revenue lost because of a loss in subscribership to a particular tier because some existing programming is dropped. The Commission declines to take into account any reduced revenue because of a loss in subscribership since any such loss is too speculative to measure accurately.[18]

The mere fact that the loss may be hard to measure accurately does not mean that the loss is not significant and should be treated as zero.[19] The Commission does not establish that there is no effect of leased access carriage on either subscribership or on the rate that an operator can charge subscribers. The Commission merely notes that these effects are difficult to measure. By ignoring the potential impact of carrying a leased access channel on a cable system's subscribership and tier rates, the Commission's proposed formula may adversely affect the financial condition of the cable system.

The Commission believes that for leased access programming carried on the BST or on a CPST the operating costs that it includes in its cost formula will continue to be covered by subscriber revenues. The Commission assumes that the cable operator will be able to generate the same amount of subscriber revenues by carrying leased access channels on the BST or CPST as the operator now generates from its current programming lineup, and therefore the operator would be indifferent between carrying its current programming or leased access programming. In the Commission's view, subscriber revenues will be

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18 *Notice* at ¶ 86.

19 The Commission's proposed cost formula allows for lost advertising revenues, but it may also be difficult to measure the lost advertising revenues associated with any particular channel because operator's typically sell local advertising by bundling time from a group of channels.

unchanged because (1 there will be no loss in subscribers due to leased access carriage and (2) since replacing an existing channel with a leased access channel leaves the number of channels unchanged, the tier rate that the operator is allowed to charge subscribers is unchanged.

Currently, subscribers pay a fee to acquire a specified package of programming. The Commission appears to believe that the same number of subscribers would be willing to pay the same amount for a different package of programming. Actual experience does not support the assumption that there will be the same number of subscribers and that subscribers would be willing to pay the same amount for leased access programs as for the existing programming. As pointed out in the previous section, if this were the case then cable operators would be eager to replace an existing cable network (and save the associated licensing fee) with a leased access channel (and obtain some positive payment) while maintaining the same level of subscriber revenues. Since there will be a reduction in subscriber revenues with leased access programming, the operator will no longer be covering all of the operating costs included in the Commission's proposed cost formula.

The Commission itself recognizes the implausibility of this assumption with regard to a leased commercial access channel replacing an existing premium service. The Commission explicitly acknowledges that it accounts for subscriber loss on premium channels in its formula and states "we cannot assume that the leased access premium service will attract the same subscribership as the non-leased access programming."[20] Yet without any analysis or any discussion as to why a premium service channel is different from a BST or a CPST channel, the Commission readily

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20 *Notice* at ¶ 94. Also see ¶ 86.

makes this very assumption for leased access programming that is carried on a BST or CPST.

At another point in the *Notice*, the Commission recognizes that its assumption regarding the impact of programming on subscribers and rates may lead to nonsensical results.[21] The Commission notes that under its proposed cost formula it is possible for an operator to calculate a negative opportunity cost for a channel.[22] The Commission also notes that operators do not carry programming that has a negative economic benefit to them, which is what a negative opportunity cost would indicate. The Commission suspects that, if a channel has a negative opportunity cost, it may be because the proposed cost formula does not account for the impact of that channel on subscriber penetration.

The Commission claims that the purpose of its proposed formula is not to lower leased access rates, but that is exactly what it is designed to do. While claiming that the formula is cost based, the Commission excludes certain costs from the formula. As a result of these exclusions, the Commission's proposed formula is likely to produce a very low maximum rate. Many cable networks do not allow for local advertising inserts by the cable operator or pay commissions to the operator.[23] Therefore, the net opportunity costs associated with these channels under the Commission's proposed formula will be very close to zero, or perhaps negative.

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21 *Notice* at ¶ 88.

22 For example, a channel that generates no local advertising revenue and pays no commissions to the cable operator yet charges the operator a programming license fee will have a negative net opportunity cost under the Commission's proposed formula.

23 Even for those cable networks that do allow local advertising inserts, in some cases the operator may not be able to sell all of the local advertising inserts that are available, and in other cases the operator may not have the necessary equipment to do local advertising insertion.

The Commission's proposal to average the opportunity costs associated with tier channels with the opportunity costs associated with premium channels does not solve this problem. While averaging increases the maximum rate for leased access channels on tiers above zero, averaging lowers the maximum rate for leased access premium channels below the calculated opportunity costs associated with those channels. Therefore, because of averaging, if a lessee wants access to a premium channel, the Commission's proposed formula will not compensate the operator for all of the opportunity costs that even the Commission itself identifies with that channel.[24]

By lowering the maximum rate, the Commission also may be encouraging channel migration. This is an issue the Commission explicitly sought to avoid when establishing the existing maximum rate formula. Setting the maximum rate too low may encourage migration of existing program services to leased access—especially high implicit fee programs such as shopping channels and pay channels. Migration will impose additional costs on the cable operator that the Commission's proposed formula does not take into account.

Tier Placement

In addition to discussing the methodology that should be used to establish the maximum rate, the *Notice* also discusses whether lessees have

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[24] For example, in the Commission's example in Appendix D of the *Notice*, the Commission calculates the opportunity cost associated with a premium channel at $17,500, but the Commission's proposed formula would allow the operator to charge at most $13,650 for the use of that channel.

the right to be placed on the BST or the CPST.[25] The right to be placed on a tier represents another subsidy to the leased commercial access programmer. By requesting placement on a tier, a lessee is free-riding on the strength of other cable networks on that tier, rather than generating a demand for its product itself. Other cable networks that seek to obtain carriage on the tier engage in marketing and promotional activities, at a significant cost, in an attempt to convince subscribers and the cable operator to carry that particular network. This competition for carriage is especially keen with the large number of emerging cable networks.

Allowing a lessee to demand carriage on a tier also diminishes the cable operators ability to assemble a package of programming that is attractive to subscribers. Economic models of program selection indicate that there is likely to be more duplicative programming when there are multiple entities (*e.g.*, the access lessees) determining program choice than when there is a single entity (*e.g.*, the cable operator). This is because the cable operator is interested in increasing total cable subscribership whereas the individual lessees are interested only in subscribership to their channels.[26]

The make-up of a tier affects not only the cable operator but also the other channels carried on the tier. Many cable networks obtain revenue from two sources that are linked to the number of subscribers to a tier: license fees from cable operators and advertising revenues. Carrying a leased access channel on a tier will affect the number of subscribers to that

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25 Notice at ¶¶ 116-120.

26 Since channels placed on tiers cannot directly charge subscribers for viewing their programming, tier carriage is biased in favor of any service that generates revenues through sales of product to subscribers or that is involved primarily in asking for donations. Tier placement is likely to benefit a small group of program types. For example, infomercials and shopping channels are the types of programs that economically can take advantage of tier placement.

tier, and hence will impact other cable networks' revenues from license fees and advertising. Hence, allowing a lessee to demand tier carriage affects the cable operator, subscribers, and other cable networks.

Other Proposals for Establishing the Maximum Reasonable Rate

Even though may be difficult to quantify some of the opportunity costs that a cable operator incurs by leasing a channel to a leased access programmer, these opportunity costs are too important to ignore and simply assume that they are zero. However, since these costs are hard to measure, it may be desirable to use a proxy. The current maximum rate formula attempts to use the highest implicit fee as a proxy.

To the extent that the Commission is operating under the assumption that the current maximum rate is too high, it may want to adopt some of the following considerations. One of the Commission's stated concerns with the current maximum rate formula is that allowing the operator to charge the leased access programmer the highest implicit fee allows the operator to set a higher rate than it accepts on non-leased access channels. One alternative would be to allow the operator to charge the average implicit fee that it accepts on non-leased access channels.[27]

The current formula does not accurately measure the highest implicit fee, because it does not measure the value of each channel to subscribers. Instead, the current formula assumes that all channels are valued equally by subscribers, and uses the average subscriber rate per channel to approximate the value of a channel to subscribers. Subtracting

27 This suggestion also was made by some commentators filing reconsideration petitions. For example, the Community Broadcasters Association proposed the average implicit fee plus a five percent incremental charge.

the lowest license fee from the average rate per channel is unlikely to yield the highest implicit fee, or indeed, the implicit fee associated with any particular channel. Since the current formula takes into account the average benefit to subscribers of the programming, it would be a more consistent measure of an actual, over-all implicit fee if the formula were based on the average license fee per channel rather than the lowest license fee.